Office - Supreme Court, U. S.
FILED
NOV 22 1941
CHARLES ELMORE CROPLEY
CLERK

Supreme Court of the United States

OCTOBER TERM 1941

No. 752

GIRARD INVESTMENT COMPANY, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF

JACKSON R. COLLINS,
Counsel for Petitioner.

Of Counsel
FRANK F. TRUSCOTT,
ROBERT I. STAPLES,
JAMES D. McHUGH,
REGINALD H. SMITH, JR.

TABLE OF CONTENTS.

PAGE

PETITION FOR WRIT OF CERTIORARI

A. Summary statement of the matter involved. 1

B. Reasons relied on for the allowance of the writ 5

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

I. Opinions of the courts below 9

II. Jurisdiction 9

III. Statement of the case 10

IV. Specification of errors 10

V. Argument 11

POINT I. The due process clause of the Fifth Amendment would be violated if the Personal Holding Company Surtax Statute were applied to the taxpayer 11

POINT II. Form 1120-H prescribed by the Commissioner of Internal Revenue is not a tax return because the information requested thereon is insufficient to determine tax liability. Form 1120-H was a mere supplemental computing sheet and not a return 17

CONCLUSION 19

CITATIONS.

CASES: PAGE

Burnett v. *Wells*, (1933) 289 U. S. 670, 53 S. C. 761 13

First National Bank of Boston v. *Commissioner*, (1933) 63 Fed. (2d) 685 13

Foley Securities Corp. v. *Commissioner*, (1939) 106 Fed. (2d) 731 16

Germantown Trust Co. v. *Commissioner*, (1940) 309 U. S. 304, 60 S. Ct. 176 18

Girard Investment Co. v. *Commissioner*, 122 Fed. (2d) 84[illegible] C. C. A. 3) 7, 15

Haffenreffer Brewing Co. v. *Commissioner*, (1940) 41 B. T. A. 443 16

Handy v. *Delaware Trust Co.*, (1932) 285 U. S. 352, 52 S. Ct. 371 12

Heiner v. *Donnan*, (1932) 285 U. S. 312, 52 S. Ct. 358 ..... 12, 13

Helvering v. *City Bank Farmers Trust Co.*, (1935) 296 U. S. 85, 56 S. Ct. 70 14

Noteman v. *Welch*, (1939) 26 Fed. Supp. 437, (District Court), (1939) 108 Fed. (2d) 206 (C. C. A. 3) 16

Purity Extract & Tonic Co. v. *Lynch*, (1912) 226 U. S. 192, 33 S. Ct. 44 16

Schlesinger v. *Wisconsin*, (1926) 270 U. S. 230, 46 S. Ct. 260 12

United States v. *Tillinghast*, (1934) 69 Fed. (2d) 718 18

Citations

PAGE

Constitutional Provisions, Statutes and Treasury Regulations

Pennsylvania Small Loan Statute, Purdon's Pennsylvania Statutes 1936, Title 7, Ch. 27, Sections 751-761 3

Revenue Act of 1934, (Personal Holding Company Surtax Statute), Sections 351, 48 Stat. 751.....1, 2, 9, 13, 16

Revenue Act of 1938, Section 402 (b), 52 Stat. 557 11

Treasury Regulations, 103, Section 19.102-2.... 11

Congressional Records and Tax Authorities

Joint Committee on Tax Evasion and Avoidance, 75th Congress, 1st Session, June 17, 18, 22, 23 & 24 (1937) 15

Public Resolution No. 40, 75th Congress, Chapter 316, 1st Session, S. J. Res. 155 14

Report 704, 73rd Congress, 2nd Session, *Ways and Means Committee,* February 12, 1934, *House Reports on Public Bills II* 3

Supreme Court of the United States,

October Term 1941

Docket No. .....

GIRARD INVESTMENT COMPANY, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

MAY IT PLEASE THE COURT:

The petitioner, Girard Investment Company, by its attorney, Jackson R. Collins, respectfully shows to this Honorable Court:

A.

Summary Statement of the Matter Involved

The case involves tax liability *eo nomine* a surtax over and above all ordinary corporate income taxes under Section 351 of the Revenue Act of 1934 and corresponding

sections applicable in subsequent years. The amounts involved are: (R. 4)

Year	*Personal Holding Company Surtax*	*Penalty*
1934	$22,177.76	$5,544.44
1935	23,990.14	5,997.54
1936	9,892.24	2,473.06

The Commissioner of Internal Revenue determined deficiencies of personal holding company surtaxes and penalties for failure to file personal holding company returns on Form 1120-H. (R. 4) The United States Board of Tax Appeals affirmed the assessment and held the taxpayer liable. (R. 25) The United States Circuit Court of Appeals for the Third Circuit by Judge William L. Clark held the taxpayer liable for the personal holding company surtax, but remanded the case to the Board for further proof with respect to the imposition of the penalties. (R. 39)

The questions involved are as follows:

1. Is a second penalty tax, which is imposed to eliminate tax avoidance or evasion, a violation of the Fifth Amendment when it is grounded upon an arbitrary status contrary to fact and when there is a subsequent finding by Congress itself that there was no avoidance and no economic equivalence?

2. Is a form prescribed by the Commissioner of Internal Revenue a tax return when the information requested thereon is insufficient to determine tax liability? Is Form 1120-H for 1935 a mere computing, supplemental sheet and not a return?

The material facts are as follows:

1. Section 351 of the Revenue Act of 1934 imposes an income surtax over and above the ordinary income tax

levied upon corporations. Under this section there is imposed upon a taxpayer an additional surtax which is designed to be a penalty, to prevent or to eliminate the use of the corporate structure as a means to minimize individual tax liability through a personal holding company. Such a company is called an "incorporated pocketbook" in the Congressional Committee Reports; *H. Rept. 704, Ways and Means, 73rd Congress 2d Session, p. 11.*

2. Section 351 defines the elements of a personal holding company. A summary description of such a corporation is where more than 50 per cent of the outstanding stock is owned by five "persons" or less and where more than 80 per cent of its gross income is received from interest, dividends, capital gains and similar items. (R. 30) Much more than 50 per cent of the capital stock of the Girard Investment Company was owned by one individual, which fact was shown on Form 1120 for the year 1935 in Schedule C. (R. 21)

3. This taxpayer, the Girard Investment Company, is a corporation organized and existing under the laws of the State of Delaware. The taxpayer is duly qualified to do business in the State of Pennsylvania, and is licensed for each year by the Secretary of Banking under the Small Loan Statutes of Pennsylvania (Pennsylvania Small Loan Act of June 17, 1915, Chapter 432, Pamphlet Laws 1012, for 1915, as amended and codified in Purdon's *Pennsylvania Statutes* 1936, Title 7, Chapter 27, Sections 751-760, page 87), as a small loan company. (R. 5) The Girard Investment Company is one of the oldest of such companies in Pennsylvania and has about fifty (50) employees and fourteen (14) offices. (R. 6)

4. During the calendar years 1934, 1935, and 1936, which are the taxable years herein involved, the taxpayer expanded its business. It received more than 7,000 applications for

small loans in 1934, and 11,000 in 1936. (R. 6) It received 63,598 instalment loan payments in 1934 and 94,318 in 1936. (R. 6) These simple illustrative facts disclosed that the company was very active and directly engaged in the business of lending small sums of money. It was an active operating company and not a holding company and certainly not a personal holding company.

5. The taxpayer filed complete ordinary income tax returns on Form 1120 for each of the calendar years, 1934, 1935, and 1936. (R. 7) For the year 1935 the taxpayer gave in its return on Form 1120 more information than was required by the designated Form 1120-H called a "personal holding company return" under Section 351. This information better enabled computation and determination of liability for the personal holding company surtax now alleged to be due than that required on Form 1120-H. (R. 16, 22) No more information was requested by the Commissioner of Internal Revenue upon his printed Form 1120-H than was required on Form 1120 and supporting schedules which were duly filed under oath and in due form for the years 1934 and 1935 on or before the date required by statute for the filing of returns.

6. Form 1120-H for 1935 required no information on stock ownership. Therefore the form was inadequate to determine tax liability, if any, under section 351 of the Revenue Act of 1934.

7. The United States Circuit Court of Appeals for the Third Circuit upheld the decision of the United States Board of Tax Appeals insofar as the petitioner was held liable for the personal holding company surtax. The case was remanded for further proceedings on the question of whether there was reasonable cause for failure to file Form 1120-H in regard to the imposition of the penalty. The United States Circuit Court of Appeals for the Third Circuit found

that more than 80 per cent of the income of the taxpayer came from interest. (R. 30) It did not discuss the constitutionality of the statute involved which declared an active operating company to be a personal holding company, nor did it consider whether the creation of such status contrary to fact was justified as a necessary means to prevent tax evasion though much time and effort was used in presenting it to the court.

B.

Reasons Relied on for the Issuance of the Writ

I.

The facts clearly show that the taxpayer is an active operating small loan company and not a personal holding company. It is not an "incorporated pocketbook" upon which the personal holding company surtax was intended to fall. This statute when applied to this taxpayer creates through the means of a definition a status contrary to fact, because its effect is to declare that an active operating company is a personal holding company. It constitutes an attempt by legislative fiat to enact into existence a fact which here does not and cannot be made to exist in actuality. The application of this statute to this taxpayer in no measure protects or aids the operation of the Federal income tax. This court has held that a statute creating a status which operates to deny a fair opportunity to rebut it violates the due process clause of the Fifth Amendment.

Moreover, the legislative declaration that this taxpayer, which is in fact an active operating company, shall be a personal holding company for the purpose of imposing tax under the statute here under review, is not a reasonable requisite to prevent tax evasion. In fact, the Congress, subsequently to the enactment of the Personal Holding Company Surtax Statute, concluded that it was not neces-

sary to include small loan companies such as this taxpayer within the statute to prevent tax evasion, and by amendment it expressly removed them from the statute's operation. The determination that the taxpayer is a personal holding company is therefore "unnecessary," "inappropriate," "unreasonably harsh" and "oppressive," when viewed in the light of the expected benefit. In consequence, the guarantee of due process is infringed.

The Personal Holding Company Surtax Statute attempts to enforce compliance with the legislative policy by imposing its tax, which has judicially been declared to be a penalty, not only upon taxpayers evading the income tax or likely to evade such tax, and threatening to defeat the legislative policy, but also upon this taxpayer, which has not evaded taxation and which threatens no harm to the legislative purpose. Congress has recognized the harmless nature of this taxpayer's activity, by expressly removing it from the operation of the statute. It is well established that innocent acts may only be penalized when the prohibition of such acts will aid the legislative purpose. For the reason, therefore, that penalizing the activity of this taxpayer would not promote the legislative objective, the statute would violate the due process clause if it imposed its burden upon this taxpayer.

The question here presented has never before been raised in any other case arising under the Personal Holding Company Surtax Statute, although as stated above the identical issue has been decided favorably by this Court to the contention of this taxpayer in cases arising under other statutes.

The statute should be construed so that it is constitutional. It is clear that if the statute applied to this taxpayer, it would violate the due process clause of the Fifth Amendment. The Personal Holding Company Surtax Statute, therefore, should be construed so as not to apply to the taxpayer, an active operating company.

II.

For the year 1935 the taxpayer filed on Form 1120 a complete sworn and subscribed disclosure of all facts required by Form 1120-H, the personal holding company surtax form, under oath and in due form on or before the due date required by statute for the filing of returns. As soon as the taxpayer learned and realized such a return was deemed insufficient it filed Form 1120-H and marked it "Amended Return." It considered Form 1120-H a supplemental schedule to the return duly filed and only a computing sheet for the additional surtax involved. Therefore, no penalty should be imposed for failure to file a personal holding company surtax return on Form 1120-H for 1935.

WHEREFORE, petitioner respectfully prays that a Writ of Certiorari be issued out of and under the seal of this Honorable Court directed to the United States Circuit Court of Appeals for the Third Circuit, demanding that Court to certify and send to this Court, for its review and determination on a day certain therein to be named, a full and complete transcript of the record and all proceedings in this case numbered and entitled on its docket "No. 7696 *Girard Investment Company* v. *Commissioner of Internal Revenue,*" and that said judgment of the United States Circuit Court of Appeals for the Third Circuit may be reviewed by this Honorable Court, and that this petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just.

November 21, 1941

JACKSON R. COLLINS
Counsel for Petitioner

Of Counsel

FRANK F. TRUSCOTT
ROBERT I. STAPLES
JAMES D. MCHUGH
REGINALD H. SMITH, JR.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I.

The Opinions of the Courts Below

The opinion of the United States Circuit Court of Appeals for the Third Circuit, October term 1940, Docket No. 7696 was rendered on August 22, 1941. It is to be found on pages 29 to 39 of the record herein; the case has been reported in the official reporter.

The opinion of the United States Board of Tax Appeals, B. T. A., Docket No. 96847, was rendered on November 25, 1940. It is to be found on pages 4 to 9 of the record herein; the case has not yet been reported in the official reporter.

II.

Jurisdiction

1. The statutory provision believed to sustain jurisdiction is Section 240 of the Judicial Code as amended by the Act of February 13, 1925 (c. 229 sec. 1, 43 Stat. 938).

2. The judgment sought to be reviewed was entered August 22, 1941.

3. The proceeding in which review is sought was initiated in the United States Board of Tax Appeals. It involves the liability of the petitioner for personal holding company surtaxes imposed by Section 351 of the Revenue Act of 1934. The United States Board of Tax Appeals found for the Commissioner of Internal Revenue and upheld the deficiency assessments. Upon petition for review the United States Circuit Court of Appeals for the Third

Circuit upheld the imposition of the personal holding company surtax on the taxpayer, but remanded the case for further proceedings on the imposition of the penalty.

III.

Statement of the Case

A full statement of the case has been given under heading "A" in the petition and in the interest of brevity is not repeated.

IV.

Specification of Errors

The United States Circuit Court of Appeals for the Third Circuit erred in the following respects:

1. In holding that the definition of a personal holding company under the Personal Holding Company Surtax Statute included the taxpayer an active small loan company because the due process clause of the Fifth Amendment would be violated if the statute were so applied to the petitioner.

2. In determining that Form 1120-H for 1935 the personal holding company surtax form was a tax return when, in fact, it was merely a supplemental computing sheet, because tax liability could not be determined from the information required therein.

ARGUMENT

POINT I

The due process clause of the Fifth Amendment would be violated if the Personal Holding Company Surtax Statute were applied to the taxpayer.

The Girard Investment Company is an active operating company engaged in the business of making small loans. A holding company, on the other hand, is clearly not an active operating company. The Treasury has defined a "holding company" as follows:

> "A corporation having practically no activities except holding property, and collecting income therefrom or investing therein, shall be considered a holding company within the meaning of section 102." *Reg. 103, Section 19.102-2 relating to the Income Tax under the Internal Revenue Code.*

The record shows that this taxpayer does not fall within this definition of a holding company. Since it does not fall within the greater definition it can not be lifted into a subdivision thereof; namely, a "personal holding company."

The taxpayer is not an "incorporated pocketbook" against which the personal holding company surtax was directed. The taxpayer was included only because the definition was inaptly and inartistically adopted in reducing the idea to words. And thus the statute defining "personal holding companies" so as to include small loan companies actively engaging in business creates a status contrary to fact. Congress recognized and rectified this error by expressly exempting this kind of small loan company from personal holding company surtaxes in the Revenue Act of 1938 (Section 402b, Revenue Act of 1938).

Where it appears from a consideration of all the relevant factors that the operation of a statute depends upon

the existence of a stated fact, a Federal statute which denies the taxpayer the opportunity to show the absence of such required fact, violates the due process clause of the Fifth Amendment to the Federal Constitution. Where Congress imposes a tax upon a stated transaction to supplement and to protect an existing revenue statute, it is established that such tax may not be exacted where the actual fact or transaction which is the basis for the tax does not exist or has not occurred, even though the Congress has ordained that under the particular circumstances the required fact shall exist or transaction shall occur.

In *Heiner* v. *Donnan,* (1932) 285 U. S. 312, a Federal statute imposing a transfer tax upon transfers made in contemplation of death and providing that *any* transfer made within two years of death shall "be deemed and held to have been made in contemplation of death" was held to violate the due process clause of the Fifth Amendment when applied to a transfer which, in fact, had not been made in contemplation of death. Justice Sutherland, who spoke for the majority, said, that:

> " * * * The presumption here excludes consideration of every fact and circumstance tending to show the real motive of the donor. * * * And, although the tax explicitly is based upon the circumstance that the thought of death must be the impelling cause of the transfer * * *, the presumption * * * precludes the ascertainment of the truth in respect of that requisite upon which the liability is made to rest, * * *, * * *, it constitutes an attempt, by legislative fiat, to enact into existence a fact which here does not, and cannot be made to, exist in actuality, * * *, * * * This Court has held more than once that a statute creating a presumption which operates to deny a fair opportunity to rebut it, violates the due process clause of the Fourteenth Amendment. * * * "

See also, *Schlesinger* v. *Wisconsin,* (1926) 270 U. S. 230; *Handy* v. *The Delaware Trust Company,* (1932) 285 U. S.

352; *First National Bank of Boston* v. *Commissioner,* (1933) 63 Fed. (2d) 685.

Mr. Justice Stone, now Chief Justice, dissented from the majority opinion of *Heiner* v. *Donnan,* supra. His opinion was based upon the thought that the exaction of the tax was justified because the objective of the statute and the effect of its operation against the gifts in question was to reasonably protect and supplement the estate tax. He said that unless the line drawn by the statute

> "is so wide of the mark as palpably to have no relation to the end sought, it is not for the judicial power to reject it and substitute another or to say that no line may be drawn."

The inclusion of small loan companies within the statute directed against personal holding companies and designed to prevent evasion of income tax does not in any measure accomplish this purpose by including small loan companies, and therefore is so wide of the mark as palpably to have no relation to the end sought. In consequence, under the dissenting opinion of Mr. Justice Stone, as well as under the majority opinion of the Court, the Personal Holding Company Surtax Statute would violate the due process clause if applied to the taxpayer.

The statute imposing a tax upon an assumption contrary to fact would not be unconstitutional if the assumption could be justified on the ground that actual transactions, property or privileges substantially similar to the fictitious transaction, property or privilege are subject to a similar tax. *Burnett* v. *Wells,* (1933) 289 U. S. 670. The active small loan companies do not enjoy the privileges enjoyed by personal holding companies. Their primary purpose is to make small loans, service them and collect them. The primary purpose of a personal holding company is to receive and hold income where others have conducted the business. Therefore Section 351 of the Revenue Act of

1934 could not, on this ground, be applied to the taxpayer without violating the Fifth Amendment.

The statute imposing a tax upon an assumption contrary to fact would not be unconstitutional if the assumption could be justified on the ground that it was reasonably necessary to prevent facile evasion of the tax. But such a statute violates the due process clause of the Fifth Amendment when the creation of such status is an "unnecessary", "inappropriate", "unreasonably harsh" and "oppressive" means of preventing tax evasion. In *Helvering* v. *City Bank Farmers Trust Company,* (1935) 296 U. S. 85, Mr. Justice ROBERTS said:

> "A legislative declaration that a status of the taxpayer's creation shall, in the application of the tax, be deemed the equivalent of another status falling normally within the scope of the taxing power, if reasonably requisite to prevent evasion, does not take property without due process. But if the means are unnecessary, or inappropriate to the proposed end, or unreasonably harsh or oppressive, when viewed in the light of the expected benefit, the guarantee of due process is infringed."

In his message in 1937 to the Congress, the President of the United States requested that loopholes in the taxing statutes be removed, and reminded Congress that "the issue immediately before us is the single one relating to the evasion or unethical avoidance of existing laws". The President then called upon the Congress to enact statutes which would prevent evasion of the revenue measures. Congress thereupon conducted an exhaustive investigation. The result of the labors of the committee appointed by Congress upon which a duty had been imposed to recommend "remedies for the evils disclosed by" its investigation of tax evasion schemes was to exempt from the operation of the Personal Holding Company Surtax Statute active small loan companies, such as the taxpayer. *Public Resolution No. 40,* 75th Congress, Chap. 316, 1st Session, S. J. Resolu-

tion 155; *Hearings Before the Joint Committee On Tax Evasion and Avoidance,* 75th Congress, 1st Session, June 17, 18, 22, 23, 24, 1937.

> "Section 402 (b) (Revenue Act of 1938) relieves personal finance companies of the burden imposed by the surtax on personal holding companies. This relief was much needed as it was impractical for many companies to continue in operation under the burden of this tax, and many of the personal finance companies deemed it impractical for them to reorganize so as not to be classed as a personal holding company; as it is necessary in some instances to keep the control of such an enterprise in the hands of only a few individuals to insure successful operation in this highly specialized field of finance."
>
> *Girard Investment Co.* v. *Commissioner,* 122 Fed. (2d) 843, decided August 22, 1941, opinion of Judge William L. Clark, p. 6 footnote 19 (R. 35).

Congress found as a fact that it was not necessary to include small loan companies within the scope of the statute to prevent evasion. Therefore, the inclusion of such companies in the statute here under consideration was an unnecessary means to prevent tax evasion and was a violation of the Fifth Amendment.

Furthermore, an "incorporated pocketbook" company, the true personal holding company, can escape the tax by distributing 90 per cent of its adjusted net income. But it is obvious that an active operating company cannot annually distribute 90 per cent of its adjusted net income while conducting a hazardous and seasonal enterprise greatly subject to the business cycle and operate efficiently or even continue in business. Therefore, to impose this tax upon the taxpayer involved "unnecessary", "inappropriate", "unreasonably harsh" and "oppressive" measures and violated the due process clause.

Further, the provisions of the Personal Holding Company Surtax Statute are penal, because their purpose is to

require the distribution of ninety per cent of a company's earnings and to force this course of action on a company by exacting a heavy tax from companies failing to distribute. This fact has been recognized in *Foley Securities Corporation* v. *Commissioner,* (1939), 106 Fed. (2d) 731, at 735, and in *Haffenreffer Brewing Company* v. *Commissioner,* (1940) 41 B. T. A. 443, at 454. It is well established that a penalty can only be imposed upon an innocent status or harmless acts when necessary to promote the legislative policy. *Purity Extract & Tontic Company* v. *Lynch* (1912) 226 U. S. 192. It is clear from the foregoing that the imposition of the burden of this statute upon a small loan company does not in any way prevent the evasion of tax. For this reason also the Personal Holding Company Surtax Statute would violate the due process clause of the Fifth Amendment if applied to this taxpayer.

The issue presented here has never before been passed upon by any court, although as shown above, identical questions have been decided favorably to the contention of the taxpayer under statutes other than the Personal Holding Company Surtax Statute. In *Noteman* v. *Welch,* (1939) 26 Fed. Sup. 437, the argument was made in the District Court that the statute violated the due process clause of the Fifth Amendment because it discriminated against small loan companies and in favor of banks. This argument was abandoned when that case was presented to the Circuit Court. *Noteman* v. *Welch,* (1939), 108 Fed. (2d) 206. This taxpayer has at no time based its argument on that subject.

The United States Circuit Court of Appeals for the Third Circuit disregarded the rules referred to above, and notwithstanding what we submit to be the controlling authority, sustained the validity of the Personal Holding Company Surtax when applied to this taxpaper. It refused to consider this conflict between the application of Section 351 of the Revenue Act of 1934 and the well and firmly established rules of law even though above half of the brief and oral argument below was devoted to this

issue. The personal holding company surtax would violate the due process clause of the Fifth Amendment if it were applied to this taxpayer.

POINT II

Form 1120-H prescribed by the Commissioner of Internal Revenue is not a tax return because the information requested thereon is insufficient to determine tax liability. Form 1120-H was a mere supplemental computing sheet and not a return.

The personal holding company surtax form, Form 1120-H, used for the tax years 1934 and 1935, herein involved, was not a tax return. It was merely a supplemental sheet computing the personal holding company surtax from the adjusted net income of the taxpayer. It required no information on the ownership of the stock of the taxpayer. It required no information on the gross income or expenses. It required no information that the taxpayer, in its return on Form 1120 for the year 1935, was not required to give. There the taxpayer carefully and fully revealed that its income was derived from interest and charges received on small loans; it revealed information on stock ownership. The only item lacking was the computation of the personal holding company surtax; this the Commissioner of Internal Revenue could have computed more easily from the information required of the taxpayer on Form 1120 than from the information required on Form 1120-H. Form 1120-H was not a return; it was a mere supplemental computing sheet. The Commissioner of Internal Revenue recognized these defects and corrected them in the forms for later years.

It is true that the personal holding company surtax was a new separate tax. But a separate tax does not necessarily require a separate return. A very similar problem

arose in *U. S.* v. *Tillinghast* (1934), 69 Fed. (2d) 718. There the taxpayer filed a return on Form 1031. The Commissioner of Internal Revenue assessed a 25 per cent penalty for failure to file in addition Form 1103, the excess-profits tax form, under the Revenue Act of 1916, Section 13(b). The Court refused to uphold the penalty. Mr. Justice MORTON said:

> "We have great doubt whether under the circumstances herein disclosed, Form 1103 can properly be regarded as a separate return, failure to make which would bar running of the Statute of Limitations. A separate form is not necessarily a separate return within the meaning of the statutory provisions relating to limitations. As has been said, the excess-profits tax was essentially a surtax on corporations based on corporate income considered in relation to invested capital."
>
> "Even if it be regarded as a separate tax, it did not necessarily call for a separate return. All the essential facts about the corporation's income and claim to deductions on which this case turns were stated and the door of inquiry pointed out in the return filed. The excess-profits form was not and did not purport to be complete in itself; it began where Form 1031 left off. It is well settled that a failure due to honest mistake to file a required schedule does not involve the penalties imposed for not making any return."

Form 1120-H picked up where Form 1120 left off.

One of the most recent decisions of the Supreme Court of the United States on this point was in the case of *Germantown Trust Company* v. *Commissioner of Internal Revenue* (1940), 309 U. S. 304, in which taxpayer filed Form 1041, intended for use by trustees, but made no income tax return for an association on Form 1120. The majority of the Court, speaking through Mr. Justice Roberts, said:

> "The respondent's contention is that where a fiduciary, in good faith, makes what it deems the appro-

priate return, which discloses all the data from which the tax, treated as one imposed upon an association (classified as a corporation under the statute), can be computed, such a return is deemed to be no return. We think this view is inadmissible."

The taxpayer, in good faith, made a full disclosure of all information required by Form 1120-H in 1935. No penalty should be assessed against a taxpayer who has acted in good faith and given complete information, merely because he has inadvertently not observed all the complicated requirements of the Treasury Department. Substance, not mere form, should be the controlling factor; full disclosure, complete candidness and good faith should be the guiding principles. Form 1120-H was not a return, but a mere supplemental computing sheet. No penalty should be assessed for failure to file it.

CONCLUSION

The taxpayer has shown that the due process clause of the Fifth Amendment would be violated if Section 351 of the Revenue Act of 1934 were applied to the taxpayer, as the statute is administered to impose a status contrary to fact without giving the taxpayer the opportunity to deny that status by showing that in fact it was not a personal holding company. The taxpayer has shown that there is no equivalence to justify the statute as active small loan companies do not enjoy the privileges enjoyed by personal holding companies and Congress itself has so found. The taxpayer has shown that the need to prevent tax evasion does not justify the statute as the means are oppressive and unnecessarily hard. The United States Circuit Court of Appeals for the Third Circuit refused to consider the conflict between the application of Section 351 to this taxpayer and the well and firmly established rules of constitutional law shown above; it refused to extend the pro-

tection of these well-established rules to the taxpayer. Furthermore, the taxpayer has shown that Form 1120-H for 1935 is not a return and that no penalty should be assessed for failure to file it.

It is respectfully submitted that this case calls for the exercise by this Court of its supervisory powers in order that the construction and constitutionality of the Federal statutes involved be definitely determined and the errors of the Circuit Court of Appeals for the Third Circuit be corrected and that to such end Writ of Certiorari should be granted and the Court should review the decision of the United States Circuit Court of Appeals for the Third Circuit and finally reverse it.

November 21, 1941.

JACKSON R. COLLINS,
Counsel for Petitioner.

Of Counsel

FRANK F. TRUSCOTT
ROBERT I. STAPLES
JAMES D. MCHUGH
REGINALD H. SMITH, JR.

INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	2
Statutes and regulations involved	2
Statement	2
Argument	6
Conclusion	11
Appendix	12

CITATIONS

Cases:	
Commissioner v. *Affiliated Enterprise*, decided November 10, 1941	6
Crooks v. *Harrelson*, 282 U. S. 55	7
Foley Securities Corp. v. *Commissioner*, 106 F. (2d) 731	6
Germantown Trust Co. v. *Commissioner*, 309 U. S. 304	11
Helvering v. *Winmill*, 305 U. S. 79	10
Logan Coal & Timber Ass'n v. *Helvering*, 122 F. (2d) 848	9
Magnano Co. v. *Hamilton*, 292 U. S. 40	7
Noteman v. *Welch*, 108 F. (2d) 206	6, 7, 9, 11
O'Sullivan Rubber Co. v. *Commissioner*, 120 F. (2d) 845	8, 9
United States v. *Jacobs*, 306 U. S. 363	8
Statutes:	
Revenue Act of 1928, c. 852, 45 Stat. 791, Section 104	7
Revenue Act of 1932, c. 209, 47 Stat. 169, Section 104	8
Revenue Act of 1934, c. 277, 48 Stat. 680:	
Section 53 (U. S. C., Title 26, Sec. 53)	12
Section 54 (U. S. C., Title 26, Sec. 54)	12
Section 62 (U. S. C., Title 26, Sec. 62)	13
Section 117 (U. S. C., Title 26, Sec. 101)	10
Section 291 (U. S. C., Title 26, Sec. 291)	13
Section 351 (U. S. C., Title 26, Sec. 351)	6, 10, 13
Revenue Act of 1935, c. 829, 49 Stat. 1014, Section 406	14
Revenue Act of 1936, c. 690, 49 Stat. 1648:	
Section 53	16
Section 54	16
Section 62	16
Section 291	15
Section 351	15
Revenue Act of 1938, c. 289, 52 Stat. 447, Section 402	7

Page

Miscellaneous:
Conference Report, H. Rep. No. 1385, 73d Cong., 2d Sess., p. 20 ---- 9
H. Rep. No. 704, 73d Cong., 2d Sess., pp.11–12 (1939–1 Cum. Bull. (Part 2) 554, 562, 563) ---- 8
S. Rep. No. 558, 73d Cong., 2d Sess., pp. 13–14 (1939–1 Cum. Bull. (Part 2) 586, 596–598) ---- 8
Treasury Regulations 86:
Art. 291–1, amended by T. D. 4626, XV–1 Cum. Bull. 61, 76–77 ---- 16
Art. 351–1 ---- 17
Art. 351–2 ---- 18
Art. 351–8 ---- 19
Treasury Regulations 94:
Art. 291–1 ---- 20
Art. 351–1 ---- 20
Art. 351–2 ---- 20
Art. 351–8 ---- 20
Treasury Regulations 101, Art. 409–1 ---- 10

In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 752

GIRARD INVESTMENT COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 4–9) is unreported. The opinion of the Circuit Court of Appeals (R. 29–39) is reported at 122 F. (2d) 843.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered August 22, 1941 (R. 39). The petition for a writ of certiorari was filed on November 22, 1941. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether Section 351 (a) and (b) (1) of the Revenue Acts of 1934 and 1936, insofar as it imposes a surtax on petitioner as a personal holding company, violates the due process clause of the Fifth Amendment.

2. Whether petitioner as a personal holding company is liable for a penalty for its delay in filing a return on Form 1120 H as required by Article 351–8 of Treasury Regulations 86 and 94, if it fails to show a reasonable cause for the delay.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra*, pp. 12–20.

STATEMENT

The facts as found by the Board of Tax Appeals may be summarized as follows (R. 4–8):

Petitioner, a Delaware corporation, is a personal finance company engaged in the small-loan business in Pennsylvania, under the provisions of the Pennsylvania Small Loan Act of June 17, 1915, as amended June 4, 1919 (R. 4–5). More than 50 percent of the value of petitioner's stock was held by not more than five persons (R. 5).

Petitioner makes loans of $300 or less to persons who do not have ordinary bank credit yet enjoy a good reputation, charging interest at not more than 3½ percent per month on unpaid bal-

ances but collecting no fees, fines, or other charges. Petitioner investigates the financial condition of prospective borrowers but does not require sureties or any collateral except occasionally when it takes an assignment of wages or a chattel mortgage on an automobile or household furniture. Petitioner's policy is to make collections by mail, telephone, or a personal call; it does not use legal processes unless it believes the borrower has attempted to defraud it or has the ability but not the willingness to pay (R. 5–6).

For each of the years 1934, 1935, and 1936 petitioner's income from the monthly rate charged borrowers for loans was in excess of 80 percent of its gross income. Its income from this source amounted to $223,993.96 in 1934, $288,722 in 1935, and $332,731.29 in 1936. It also had temporary investments of funds not required in the business aggregating $51,656.44 at the end of 1934, and $4,575 at the end of 1936. Petitioner's expenditures for making, servicing, and collecting its loans were approximately $111,000 in 1934, $139,000 in 1935, and $199,000 in 1936, and represented between about 43 percent and 58 percent of its annual gross income. Those expenditures were, for the most part, for salaries, rent, advertising, telephone and postage, legal expense, and automobile expense. Petitioner did not keep any record of the cost of making, servicing, and collecting each individual loan (R. 6–7).

Petitioner filed Schedule C–1, entitled "Annual Information by Corporations", with its 1934 income tax return and stated on it that Harry D. Holloway, the petitioner's president, owned 99 3/10 percent of the common stock and 32 percent of the preferred (R. 7). Its 1935 return stated that it was of the opinion that it was not a personal holding company but an operating small loans company. Its 1936 return stated that the Bureau of Internal Revenue had assessed the company as a personal holding company and that such assessment had been protested (R. 7). Not until June 3, 1939, did petitioner file Form 1120 H prescribed for personal holding companies. Article 351–8 of Treasury Regulations 86 and 94. Then, several months after proceedings before the Board had commenced, it adopted the suggestion of the revenue agent's office and of the Commissioner's technical staff and filed reports for the three taxable years stating that it believed it had already complied with the statute "as it had made a full disclosure of its position and its items of income and deductions, if any" (R. 8).

In the notice of deficiency dated October 28, 1938, the Commissioner held that at least 80 percent of petitioner's gross income for the taxable years was derived from dividends, interest, and gains from the sale of stock or securities; that during the last half of each taxable year more than 50 percent in value of its outstanding stock

was owned, directly or indirectly, by not more than five individuals; and that petitioner was therefore a personal holding company within the purview of Section 351 of the Revenue Acts of 1934 and 1936. He also held that since petitioner had not by that time filed personal holding company returns on Form 1120 H, it was liable for the 25 percent penalty for failure to file such returns (R. 7–8).

The Board agreed; it held (1) that petitioner was a personal holding company within the meaning of the statutes, (2) that the imposition of the personal holding company surtax did not violate the Fifth Amendment, and (3) that petitioner was liable for a penalty for failure to file a return on Form 1120 H (R. 8–9). Deficiencies in personal holding company surtax were found to be due in the amounts of $22,177.76, $23,990.14, and $9,892.24 for the years 1934, 1935, and 1936, respectively, and penalties in the amounts of $5,544.44, $5,997.54, and $2,473.06 (R. 25–26).

The court below approved the imposition of the personal holding company surtax. As to the penalty, however, it held that petitioner should be given an opportunity to show whether there was reasonable cause for its delay in filing the return required of personal holding companies and remanded the cause for further proceedings (R. 38–39).

ARGUMENT

I

Section 351 of the Revenue Acts of 1934 and 1936 (Appendix, *infra*, pp. 13, 15) imposes a surtax on personal holding companies and defines such companies as including any corporation (with certain exceptions not material here)—

> * * * if—(A) at least 80 per centum of its gross income for the taxable year is derived from * * * interest, * * * and (B) at any time during the last half of the taxable year more than 50 per centum in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals. * * *

Petitioner does not now deny that it comes squarely within this definition.[1] The language covers operating companies as well as mere holding companies and must be literally construed. *Noteman* v. *Welch*, 108 F. (2d) 206 (C. C. A. 1); *Commissioner* v. *Affiliated Enterprises, Inc.* (C. C. A. 10), decided November 10, 1941, not officially reported but found in 1941 C. C. H., Vol. 4, par. 9735. Also compare *Foley Securities Corp.* v. *Commissioner*, 106 F. (2d) 731 (C. C. A. 8). Any possible doubt would be laid at rest by the refusal of Congress in 1935, 1936 and 1937 to modify the section to exclude small loan companies and the

[1] In the court below it was contended that less than 80 percent of petitioner's income was from interest, but this contention has now been abandoned.

exclusion of some but not all small loan companies in Section 402 of the Revenue Act of 1938, c. 289, 52 Stat. 447. See *Noteman* v. *Welch, supra,* at 208–210.

Petitioner's contention that as applied to it Section 351 is unconstitutional raises no substantial question. Its argument is that the statute attempts contrary to fact to constitute petitioner a personal holding company and therefore is arbitrary and capricious. But the question is not whether petitioner can be made a personal holding company by legislative fiat. It is whether Congress can constitutionally tax as a separate class corporations coming within the definition.

There can be no doubt of the answer to that question. Congress may select the subjects of taxation and qualify them differently as it sees fit, and in doing so does not violate the due-process clause of the Fifth Amendment unless the statute is so arbitrary as to compel the conclusion that it does not involve an exertion of the taxing power but is a confiscation of property. *Magnano Co.* v. *Hamilton,* 292 U. S. 40, 44; *Crooks* v. *Harrelson,* 282 U. S. 55, 60.

The treatment accorded companies falling within Section 351 (b) (1) and other corporations was not very different. Prior to 1934, the revenue acts had imposed an additional tax on certain corporations which accumulated surpluses, including both operating and holding companies (Sec-

tion 104 (a) of the Revenue Act of 1928, c. 852, 45 Stat. 791, and of the Revenue Act of 1932, c. 209, 47 Stat. 169). However, as such tax was difficult to collect, Congress decided to divide Section 104 into two parts. It placed in Section 351 the companies which it called personal holding companies, while by Section 102 it imposed a slightly lower tax on all other corporations.[2]

Ample grounds exist for this small difference as applied to petitioner. While it is true that Congress enacted Section 351 to reach the "incorporated pocketbook," in correcting the evil it was not confined to the specific instances which suggested the remedy. *O'Sullivan Rubber Co.* v. *Commissioner,* 120 F. (2d) 845 (C. C. A. 2). It is immaterial, therefore, whether petitioner was formed to avoid taxes and whether small-loan companies could have been excluded without encouraging tax avoidance. Other facts such as that petitioner's president owned 99 3/10 per cent of the common stock and 32 per cent of the preferred, suggest that Congress undoubtedly had ample grounds for grouping this kind of corporation with the "incorporated pocketbook." We need not speculate as to other reasons. The presumption that an act of Congress is valid applies with added force to a levy for public revenue. *United States* v. *Jacobs,* 306 U. S. 363, 371.

---

[2] See S. Rep. No. 558, 73d Cong., 2d Sess., pp. 13–14 (1939–1 Cum. Bull. (Part 2) 586, 596–598); H. Rep. No. 704, 73d Cong., 2d Sess., pp. 11–12 (1939–1 Cum. Bull. (Part 2) 554, 562, 563).

II

The second question presented, whether petitioner as a personal holding company was required to file a separate return on Form 1120H prescribed by Article 351–8 of Treasury Regulations 86 and 94, is not sufficiently important to warrant review by this Court. As petitioner states (Br., p. 17) the form has been changed. The Circuit Courts of Appeals which have considered the question are agreed that the return was required. *Noteman* v. *Welch,* 108 F. (2d) 206 (C. C. A. 1); *O'Sullivan Rubber Co.* v. *Commissioner,* 120 F. (2d) 845 (C. C. A. 2); *Logan Coal & Timber Ass'n* v. *Helvering,* 122 F. (2d) 848 (C. C. A. 3). Furthermore, proceedings below have not been completed for the Circuit Court of Appeals remanded the cause to the Board of Tax Appeals to determine whether there was reasonable cause for delay in filing the return (R. 39).

Moreover, the court below was plainly right in holding that the separate returns on Form 1120H were required. Section 351 (c) explicitly authorizes the requirement of a separate return.[3] Article 351–8 of Treasury Regulations 86 and 94 prescribed it (Appendix, *infra,* pp. 16–20). As this re-

[3] See Conference Report, 73d Cong., 2d Sess., H. Rep. No. 1385, p. 20, which says, "The Senate Amendment provides for a separate return for the purposes of this surtax on personal holding companies. * * * The House recedes on amendment no. 45."

quirement also appeared in Article 409–1 of Regulations 101, issued under the Revenue Act of 1938, those regulations have Congressional approval. *Helvering* v. *Winmill,* 305 U. S. 79.

Form 1120H was not merely a supplementary sheet to the income-tax return but a separate return for surtax purposes. Surtax on a personal holding company was laid on the "undistributed adjusted net income" as defined in Section 351 (b) (2) (3) of the Revenue Acts of 1934 and 1936. In computing such tax the taxpayer might deduct among other items (1) federal income, war profits, and excess-profits taxes; (2) contributions or gifts; (3) losses from sale or exchange of capital assets disallowed by Section 117 (d) of the Revenue Act of 1934; (4) dividends from personal holding companies; and (5) amounts used or set aside to retire indebtedness. None of these items was deductible in computing the normal tax, and only the taxes are given on the income-tax return.

While the latter return requires a taxpayer to state whether it is a personal holding company, the taxpayer is not required to indicate how its stock is held. Also a taxpayer may not disclose the nature of its gross income in the income-tax return, as in the instant case where the petitioner simply described the bulk of its income merely as gross profit. For both reasons the Commissioner could not tell from the income-tax return whether

a taxpayer was a personal holding company. Petitioner's return for 1935 is a fair example (R. 16–18). There was not a full disclosure of the relevant facts. See *Noteman* v. *Welch, supra,* at 215.

This case is distinguishable from *Germantown Trust Co.* v. *Commissioner,* 309 U. S. 304, on which petitioner relies. The income tax returns here did not purport to be its returns for surtax purposes. Moreover in that case the question was whether in case of failure tc file the correct return it could be said that there was "a failure to file a return" whereas the question here was whether there was "any failure to make and file a return required" by law. (Compare Section 276 (c) of Revenue Act of 1932 with Section 291 of the Revenue Act of 1934 and 1936 and Section 406 of the Revenue Act of 1935.)

CONCLUSION

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

CHARLES FAHY,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
J. LOUIS MONARCH,
LOUISE FOSTER,
Special Assistants to the Attorney General.

DECEMBER 1941.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 53. TIME AND PLACE FOR FILING RETURNS.

(a) *Time for Filing.*—

(1) *General rule.*—Returns made on the basis of the calendar year shall be made on or before the 15th day of March following the close of the calendar year. Returns made on the basis of a fiscal year shall be made on or before the 15th day of the third month following the close of the fiscal year.

(2) *Extension of time.*—The Commissioner may grant a reasonable extension of time for filing returns, under such rules and regulations as he shall prescribe with the approval of the Secretary. Except in the case of taxpayers who are abroad, no such extension shall be for more than six months.

* * * * *

(U. S. C., Title 26, Sec. 53.)

SEC. 54. RECORDS AND SPECIAL RETURNS.

(a) *By Taxpayer.*—Every person liable to any tax imposed by this title or for the collection thereof, shall keep such records, render under oath such statements, make such returns, and comply with such rules and regulations, as the Commissioner with the approval of the Secretary, may from time to time prescribe.

* * * * *

(U. S. C., Title 26, Sec. 54.)

SEC. 62. RULES AND REGULATIONS.

The Commissioner, with the approval of the Secretary, shall prescribe and publish all needful rules and regulations for the enforcement of this title (U. S. C., Title 26, Sec. 62).

SEC. 291. FAILURE TO FILE RETURN.

In case of any failure to make and file a return required by this title, within the time prescribed by law or prescribed by the Commissioner in pursuance of law, 25 per centum of the tax shall be added to the tax, except that when a return is filed after such time and it is shown that the failure to file it was due to reasonable cause and not due to willful neglect no such addition shall be made to the tax. The amount so added to any tax shall be collected at the same time and in the same manner and as a part of the tax unless the tax has been paid before the discovery of the neglect, in which case the amount so added shall be collected in the same manner as the tax. The amount added to the tax under this section shall be in lieu of the 25 per centum addition to the tax provided in section 3176 of the Revised Statutes, as amended (U. S. C., Title 26, Sec. 291).

SEC. 351. SURTAX ON PERSONAL HOLDING COMPANIES.

(a) *Imposition of Tax.*—There shall be levied, collected, and paid, for each taxable year, upon the undistributed adjusted net income of every personal holding company a surtax equal to the sum of the following:

(1) 30 per centum of the amount thereof not in excess of $100,000; plus

(2) 40 per centum of the amount thereof in excess of $100,000.

(b) *Definitions.*—As used in this title—

(1) The term "personal holding company" means any corporation (other than a corporation exempt from taxation under section 101, and other than a bank or trust company incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits, and other than a life-insurance company or surety company) if—(A) at least 80 per centum of its gross income for the taxable year is derived from royalties, dividends, interest, annuities, and (except in the case of regular dealers in stock or securities) gains from the sale of stock or securities, and (B) at any time during the last half of the taxable year more than 50 per centum in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals. * * *

(c) *Administrative Provisions.*—All provisions of law (including penalties) applicable in respect of the taxes imposed by Title I of this Act, shall insofar as not inconsistent with this section, be applicable in respect of the tax imposed by this section, except that the provisions of section 131 of that title shall not be applicable.

* * * * *

(U. S. C., Title 26, Sec. 331.)

Revenue Act of 1935, c. 829, 49 Stat. 1014:

SEC. 406. FAILURE TO FILE RETURNS.

In the case of a failure to make and file an internal-revenue tax return required by law, within the time prescribed by law or prescribed by the Commissioner in pursu-

ance of law, if the last date so prescribed for filing the return is after the date of the enactment of this Act, if a 25 per centum addition to the tax is prescribed by existing law, then there shall be added to the tax, in lieu of such 25 per centum: 5 per centum if the failure is for not more than 30 days, with an additional 5 per centum for each additional 30 days or fraction thereof during which failure continues, not to exceed 25 per centum in the aggregate.

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 291. FAILURE TO FILE RETURN.

In case of any failure to make and file return required by this title, within the time prescribed by law or prescribed by the Commissioner in pursuance of law, unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the tax: 5 per centum if the failure is for not more than thirty days with an additional 5 per centum for each additional thirty days or fraction thereof during which such failure continues, not exceeding 25 per centum in the aggregate. The amount so added to any tax shall be collected at the same time and in the same manner and as a part of the tax unless the tax has been paid before the discovery of the neglect, in which case the amount so added shall be collected in the same manner as the tax. The amount added to the tax under this section shall be in lieu of the 25 per centum addition to the tax provided in section 3176 of the Revised Statutes, as amended.

SEC. 351. SURTAX ON PERSONAL HOLDING COMPANIES.

(a) *Imposition of Tax.*—There shall be levied, collected, and paid, for each taxable

year (in addition to the taxes imposed by Title I), upon the undistributed adjusted net income of every personal holding company a surtax equal to the sum of the following:

(1) 8 per centum of the amount thereof not in excess of $2,000; plus

(2) 18 per centum of the amount thereof in excess of $2,000 and not in excess of $100,000; plus

(3) 28 per centum of the amount thereof in excess of $100,000 and not in excess of $500,000; plus

(4) 38 per centum of the amount thereof in excess of $500,000 and not in excess of $1,000,000; plus

(5) 48 per centum of the amount thereof in excess of $1,000,000.

* * * * *

Sections 53, 54, 62, and 351 (b) and (c) of the Revenue Act of 1936 contain the same provisions as those given in Sections 53, 54, 62, and 351 (b) and (c), respectively, of the Revenue Act of 1934, *supra.*

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 291–1. *Addition to the tax in case of failure to file return.*—In case of failure to make and file a return required by Title I within the prescribed time, 25 per cent of the amount of the tax is added to the tax unless the return is later filed and failure to file the return within the prescribed time is shown to the satisfaction of the Commissioner to be due to reasonable cause and not to willful neglect. Two classes of delinquents are subject to this addition to the tax:

(a) Those who do not file returns and for whom returns are made by a collector or the Commissioner, and

(b) Those who file tardy returns and are unable to show reasonable cause for the delay.

A taxpayer who files a tardy return and wishes to avoid the addition to the tax must make an affirmative showing of all facts alleged as a reasonable cause for failure to file the return on time in the form of an affidavit which should be attached to the return. If such an affidavit is furnished with the return or upon the collector's demand, the collector, unless otherwise directed by the Commissioner, will forward the affidavit with the return, and, if the Commissioner determines that the delinquency was due to a reasonable cause and not to willful neglect, the 25 per cent addition to the tax will not be assessed. If the taxpayer exercised ordinary business care and prudence and was nevertheless unable to file the return in the prescribed time, then the delay is due to reasonable cause.

If the 25 per cent addition to the tax for delinquency in filing the return has been added, the amount so added shall be collected in the same manner as the tax.

* * * * *

ART. 351–1. *Surtax on personal holding companies.*—Section 351 of Title IA imposes an additional graduated income tax or surtax upon corporations classified as personal holding companies. Corporations so classified are exempt from the surtax on corporations improperly accumulating surplus imposed by section 102 of Title I, but are not exempt from the other taxes imposed by that title. Unlike the surtax im-

posed by section 102, the surtax imposed by section 351 applies to all personal holding companies defined as such in article 351–2 regardless of whether or not they were formed or availed of to accumulate gains and profits for the purpose of avoiding surtax upon shareholders.

ART. 351–2. *Classification of a personal holding company.*—* * *

It is the nature of the gross income and the ownership of the outstanding stock which determine the classification as a personal holding company, and the several conditions with respect to both must be satisfied to bring a corporation within the classification. Gross income must be determined for the entire taxable year and the ownership of the stock outstanding must be determined according to its ownership at any time during the last half of the taxable year. Inasmuch as such circumstances can vary from year to year, a corporation may constitute a personal holding company for some years and not for other years. In that case, the surtax liability shall be determined under section 351 only for the years in which the corporation comes within the classification as a personal holding company, while the liability for surtax as to the other years will depend upon whether the corporation comes within the provisions of section 102 with respect to such years.

* * * * *

(3) *Interest.*—The term "interest" means any amounts received for the use of borrowed money which are includible in gross income under Title I.

* * * * *

ART. 351–8. *Return and payment of tax.*—A separate return is required for the surtax imposed under section 351. Such return shall be made on Form 1120H. In the case of a personal holding company which is a domestic corporation, the return is required to be made within the time prescribed in section 53 and in the case of a foreign corporation within the time prescribed in section 235. The tax shown by the corporation on its return must be paid in the case of a domestic corporation within the time prescribed in section 56 and in the case of a foreign corporation within the time prescribed in section 236. The same provisions of law relating to the period of limitation for assessment and collection which govern the taxes imposed by Title I also apply to the surtax imposed under Title IA. However, since the surtax imposed under Title IA is a distinct and separate tax from those imposed under Title I, the making of a return under Title I will not start the period of limitation for assessment of the surtax imposed under Title IA. If the corporation subject to section 351 fails to make a return, the tax may be assessed at any time. If the Commissioner finds a deficiency in respect of the tax imposed by section 351, he is required to follow the same procedure which applies to deficiencies in income tax under Title I. The penalties applicable to the income taxes imposed under Title I, as well as the provisions of Title I relating to interest and additions to the tax, also apply to the surtax imposed by section 351. The administrative provisions applicable to the surtax imposed by section 351 are not confined to those contained in Title I but embrace all

administrative provisions of law which have any application to income taxes.

Articles 291–1, 351–1, 351–2, 351–8 of Treasury Regulations 94, promulgated under the Revenue Act of 1936, contain provisions similar to the articles with the same numbers in Regulations 86. Art. 291–1 of Treasury Regulations 86 was amended by T. D. 4626, XV–1 Cum. Bull. 61, 76–77, but the only material change was with reference to the size of the penalty which was made to accord with the amendment in the Revenue Act of 1935, Sec. 406.

U. S. GOVERNMENT PRINTING OFFICE: 1941